

**GRS RESEARCH MEMORANDUM¹**

RE: **Maximum Deferral and Threshold Limits for 2004 and 2005**
 FROM: Paul Zorn and Mary Ann Vitale
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The Internal Revenue Code (IRC) establishes a number of limits on retirement plan benefits and contributions. The limits are located in numerous sections of the Code and often apply in different ways to private and public-sector plans. Generally, plans must comply with the limits to maintain their tax-qualified status.

The Internal Revenue Service (IRS) periodically increases certain limits to reflect changes in the Consumer Price Index. In many cases, the adjustment is only made if the change in the limit attributable to the CPI exceeds a certain amount (e.g., \$1,000 or \$5,000). On October 20, 2004, the IRS published new limits in IRS Release IR-2004-127, generally effective January 1, 2005. The table below presents key limits for 2005 and compares them with the 2004 limits. The remainder of this memo briefly summarizes the limits referenced in the table.

Maximum Deferral and Threshold Limits for 2004 and 2005

	2004	2005
Maximum Accrued Benefit Dollar Limit IRC § 415(b)(1)(A)	\$165,000	\$170,000
Special Firefighter/Police 415(b) Dollar Limit IRC § 415(b)(2)(G)	165,000	170,000
Maximum Contribution to a Qualified Defined Contribution Plan IRC § 415(c)(1)(A)	41,000	42,000
Maximum Compensation Limit IRC § 401(a)(17)	205,000	210,000
Maximum Compensation Limit in Lieu of OBRA '93 IRC § 401(a)(17)	305,000	315,000
Elective Deferral Maximum for 401(k) Plans and 403(b) Plans IRC § 402(g)(1)	13,000	14,000
Elective Deferral Maximum for 457 Plans IRC § 457(e)(15)	13,000	14,000
Catch-Up Limit (Age 50 and Older) for 401(k), 403(b) and 457 Plans IRC § 414(v)(2)(B)(i)	3,000	4,000
Catch-Up Limit (Age 50 and Older) for SIMPLE Plans IRC § 414(v)(2)(B)(ii)	1,500	2,000
IRA Contribution Limit	3,000	4,000
IRA Catch-Up Limit (Age 50 and Older) IRC § 219(b)(5)(B)(ii)	500	500
Social Security Maximum Taxable Wage – OASDI	87,900	90,000
Social Security Maximum Taxable Wage – HI	No Limit	No Limit

Sources: IRS Release IR-2004-127 and SSA "2005 Social Security Changes" Fact Sheet.

¹ This memorandum describes changes to certain tax rules applicable to retirement plans. The authors are not attorneys and the statements made are not intended as legal advice or opinion. Plan administrators should seek the advice of qualified legal counsel to ensure that plan documents comply with applicable federal laws and regulations.

Maximum Accrued Benefits

IRC § 415 limits the benefits that can accrue in defined benefit plans and the amounts contributed to defined contribution plans. Generally, IRC § 415(b) limits the employer-provided benefits that can accrue to members in a defined benefit plan to the lesser of \$170,000 in 2005 (the "dollar limit") or 100 percent of compensation. Although private-sector plans are subject to both limits, governmental plans are exempt from the 100 percent of compensation limit.

IRC § 415(b) also requires the dollar limit to be actuarially reduced for retirement before age 62, using a prescribed mortality table. However, for certain qualified police and firefighters with at least 15 years of service credit, no actuarial reduction is required. Consequently, the dollar limit for these members is the same as the unreduced § 415(b) dollar limit, or \$170,000 in 2005, regardless of age.

Maximum Contributions

IRC § 415(c) limits the maximum "annual additions" to a defined contribution plan to the lesser of \$42,000 in 2005, or 100 percent of annual compensation. In this context, annual additions include employer and employee contributions, as well as forfeitures. Due to changes made by the Taxpayer Relief Act of 1997, annual compensation, for the purpose of determining this limit, includes elective deferrals to 401(k), 403(b), 457(b) and 125 "cafeteria" plans.

For governmental plans that do not "pick-up" mandatory employee contributions under IRC § 414(h)(2), employee contributions are treated as contributions to a defined contribution plan and are subject to the § 415(c) limits. For governmental plans that do "pick-up" employee contributions, the contributions are treated as part of the employer-provided portion of accrued benefits subject to the § 415(b) dollar limits.

Maximum Compensation

IRC § 401(a)(17) limits the amount of compensation that can be taken into account by the plan, for the purpose of determining benefits and contributions, to \$210,000 in 2005. For private-sector plans, even if a plan member earns more than this amount, only \$210,000 may be used in 2005 to calculate employee contributions to, or benefits provided by, the qualified plan.

Special rules apply to some public-sector plan members hired before 1996. In 1993, IRC § 401(a)(17) was amended by the Omnibus Budget Reconciliation Act (OBRA '93), lowering the maximum compensation limit from \$200,000 to \$150,000, indexed for inflation. OBRA '93 allowed governmental plans to grandfather the compensation limits specified in the plan as of July 1, 1993, for employees hired before 1996 – provided the plan was amended to apply the OBRA '93 limits to employees hired in 1996 and after. For governmental plans applying the pre-OBRA '93 limits, the maximum compensation limit in 2005 is \$315,000 for grandfathered employees. For governmental plans that had no maximum compensation limit as of July 1, 1993, and that amended the plan to grandfather these provisions, benefits can be determined without reference to any compensation limit for grandfathered employees.

Maximum Elective Deferrals

Elective deferrals are voluntary agreements in which employees elect to forgo current income in return for the employer's contributions to retirement or other benefit plans. Elective deferrals are available for a variety of tax-qualified retirement plans, including 401(k) and 403(b) plans, for which the maximum elective deferral per participant is \$14,000 in 2005. Governmental employees may have access to non-qualified deferred compensation plans established under IRC § 457(b). The maximum elective deferral for 457(b) plans is also increased to \$14,000 in 2005.

IRA Contribution Limit

The maximum annual contribution to a traditional IRA and a Roth IRA increased to \$4,000 for 2005.

Catch-Up Dollar Limits

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) added IRC § 414(v), providing new “catch-up” provisions for participants in 401(k), 403(b), 457(b), SEPs, IRAs, and SIMPLE plans. Under the new provisions, plan participants who are or will be age 50 or older by the end of the plan year may voluntarily make additional contributions to the plan, above the maximum elective deferral limits. The maximum catch-up contribution is the lesser of (1) a specific dollar amount (the “catch-up dollar limit”) or (2) the participant’s compensation for the year reduced by any other elective deferrals made during the year. For 2005, the catch-up dollar limit for 401(k), 403(b), SEPs, and 457(b) plans is \$4,000. For SIMPLE plans, the 2005 catch-up dollar limit is \$2,000. For IRAs, the catch-up dollar limit is \$500.

Note: 457(b) plans have an additional catch-up provision under IRC § 457(b)(3). As amended by EGTRRA, a participant may, in one or more of the three years ending before normal retirement age, defer the lesser of (1) twice the applicable dollar limit (i.e., twice \$14,000 or \$28,000 in 2005) or (2) the sum of the applicable dollar limit for the year (i.e., \$14,000 in 2005) plus the amount by which the applicable dollar limit in preceding years exceeded actual deferrals in those years. In the three years ending before normal retirement age, a 457(b) plan participant may apply the greater of the 414(v) catch-up provision or the 457(b)(3) catch-up provision, but not both.

Taxable Wage Base for Social Security and Medicare

The taxable wage base limits the amount of earnings that are taxable under Social Security’s Old Age, Survivor, and Disability Insurance (OASDI) program. Both employers and employees pay a 6.20% payroll tax on these earnings to fund the OASDI program. The taxable wage base is adjusted annually for inflation and is increased to \$90,000 for 2005. Because the maximum taxable wage base for Medicare (HI) was eliminated by OBRA ’93, there is no limit on the earnings subject to the 1.45% Medicare tax.

On October 19, 2004, the Social Security Administration (SSA) announced a 2.7% cost-of-living adjustment for 2005. The adjustment is based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the third quarter of 2003 to the third quarter of 2004. The cost-of-living adjustment will be effective for payments in January 2005 to Social Security and Supplemental Security Income (SSI) beneficiaries.

Links

IRS News Release (IR-2004-127) is at: <http://www.irs.gov/newsroom/>

Social Security Changes for 2005 is at: <http://www.ssa.gov/pressoffice/factsheets/colafacts2005-alt.htm>